

**PART 1**

**MAIN DEVELOPMENTS**

## **Adjustments to the calculations of nominal and real effective exchange rates**

Since the second quarter of 2004, nominal and real effective exchange rates in this report are calculated based on a reference group of 41 countries. By extending the group of reference countries from 24 countries to 41 countries, over 80 percent of extra-EU12 exports instead of 58 percent are covered. The effective exchange rate calculations consequently better reflect trade patterns, including those with the new Member States.

The new reference group has been constructed by extending the former IC24 group (which includes the former 15 EU countries, Norway, Switzerland, Australia, the United States, Canada, Japan, Mexico, New Zealand and Turkey) with the ten recently acceded Member States, Bulgaria, Romania, Russia, China, Brazil, Korea and Hong Kong. Due to data constraints, real effective exchange rates based on unit labour costs cannot be calculated for this group. Therefore, for the time being, only real effective exchange rates calculated to measure *price competitiveness* are based on this new reference group (broad group). Real effective exchange rates calculated to measure *cost competitiveness* are based on a smaller reference group of 34 countries (the former IC24 group plus the ten new Member States).

The present format of the report reflects these changes. The “broad group” is included in the tables and charts of part 1 where appropriate. An additional page has been added to the first part, which provides analysis for both price and cost competitiveness. In the tables and charts on pages 1 to 65 of part 2, each country’s relative position is assessed with respect to the rest of 34 countries (the EU25 countries, Norway, Australia, Canada, Japan, the United States, Mexico, New Zealand, Turkey and Switzerland), with the European Union and with the euro area.

## **DEVELOPMENTS OF PRICE AND COST COMPETITIVENESS IN THE EUROPEAN UNION, THE UNITED STATES AND JAPAN**

### **MAIN FEATURES**

#### **The euro against major international currencies**

- The euro exchange rate appreciated strongly against most major currencies between the third and the fourth quarter of 2004. On average, the euro gained 6.1 percent against the US dollar, 3.4 percent against the pound sterling and 2.0 percent against the Japanese yen. Compared to the fourth quarter of 2003, the euro exchange rate gained 9 percent against the US dollar and almost 6 percent against the yen, but slightly lost against the pound sterling.
- All in all, the euro appreciated by 2.5 percent against the currencies of 29 countries during the fourth quarter. Compared to the fourth quarter of 2003, the euro appreciated by 3.1 percent and is now more than 19 percent above its 1995-2004 average.

#### **Relative cost and price indicators: international developments**

- The strong nominal appreciation led to a deterioration of cost competitiveness of euro area producers by 1.9 percent compared to the third quarter of 2004. The real effective exchange rate based on the unit labour cost deflator is around 3.5 percent above its 1995-2004 average. The price competitiveness position is now more than 7 percent worse than its 1995-2004 average.
- In the US, cost competitiveness improved further over the fourth quarter of 2004, with the real effective exchange rate being almost 9 percent below its 1995-2004 average. The small depreciation of the yen in real effective terms helped to underpin Japanese cost competitiveness, which in the fourth quarter of 2004 was more than 20 percent below its 1995-2004 average.

#### **Relative cost and price indicators: intra-euro area developments**

- Over the *last year*, only Germany and the Netherlands faced a further improvement of their cost competitiveness relative to their euro area partners. As regards price competitiveness, Austria and Finland joined the group of countries with competitiveness gains. Of all other countries, Greece recorded the strongest loss in cost competitiveness.
- In a *medium-term perspective*, the current position of intra-euro area cost and price competitiveness of Germany and to much lesser extent of Austria, France and Finland is more favourable than its 1995 to 2004 average. On the other hand, Portugal, Italy, Ireland, Spain and Greece still experience competitiveness positions that are considerably worse than their 1995-2004 averages. In the Netherlands, the improvements since the second half of 2003 have led to a slight closing of the gap between actual and medium-term competitiveness positions.

#### **Relative cost and price indicators: non-euro area Member States**

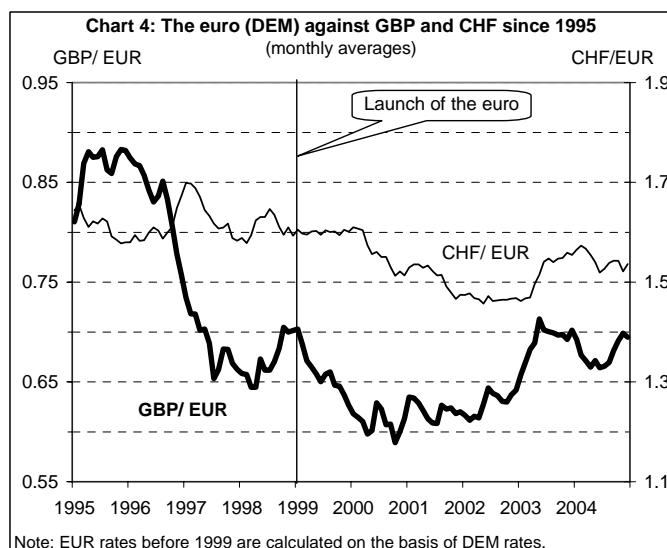
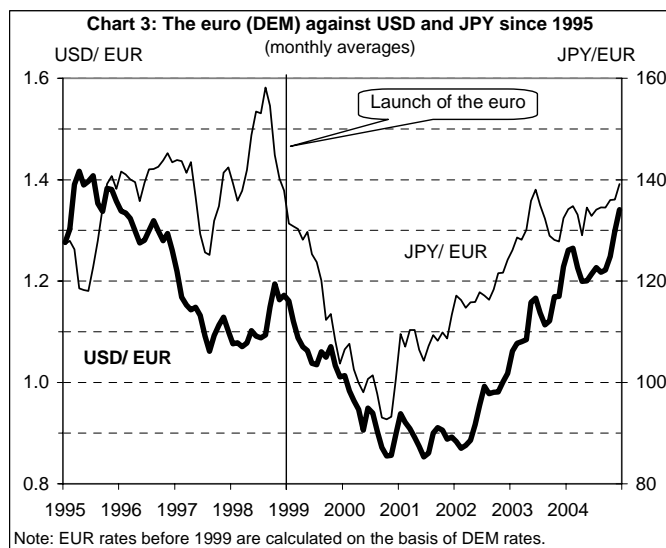
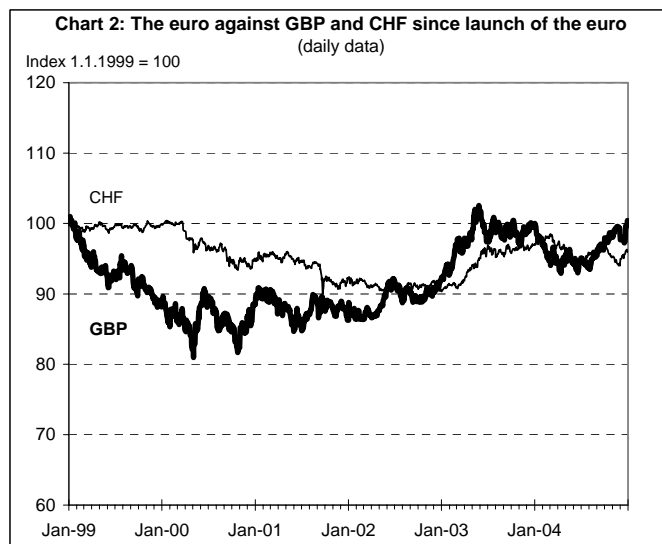
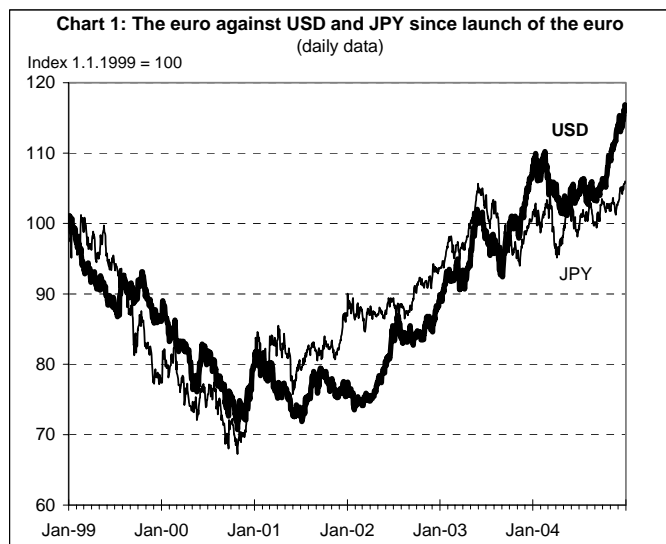
- In the UK, cost and price competitiveness against the euro area improved over the fourth quarter of 2004. Nevertheless, the cost competitiveness position is still some 5 percent worse than its 1995-2004 average.
- In all other non-euro area Member States, cost competitiveness over the fourth quarter of 2004 only improved in Malta and Latvia. All other Member States experienced a deterioration of cost competitiveness against the euro area. Except for Sweden, current cost competitiveness positions are worse than the 1995-2004 average in all non-euro area Member States, with indicators in terms of unit labour costs showing a deterioration of between 0.2 percent and 33 percent.

# DATA ON PRICE AND COST COMPETITIVENESS

## QUARTERLY REPORT - FOURTH QUARTER 2004

### I. INTERNATIONAL DEVELOPMENTS

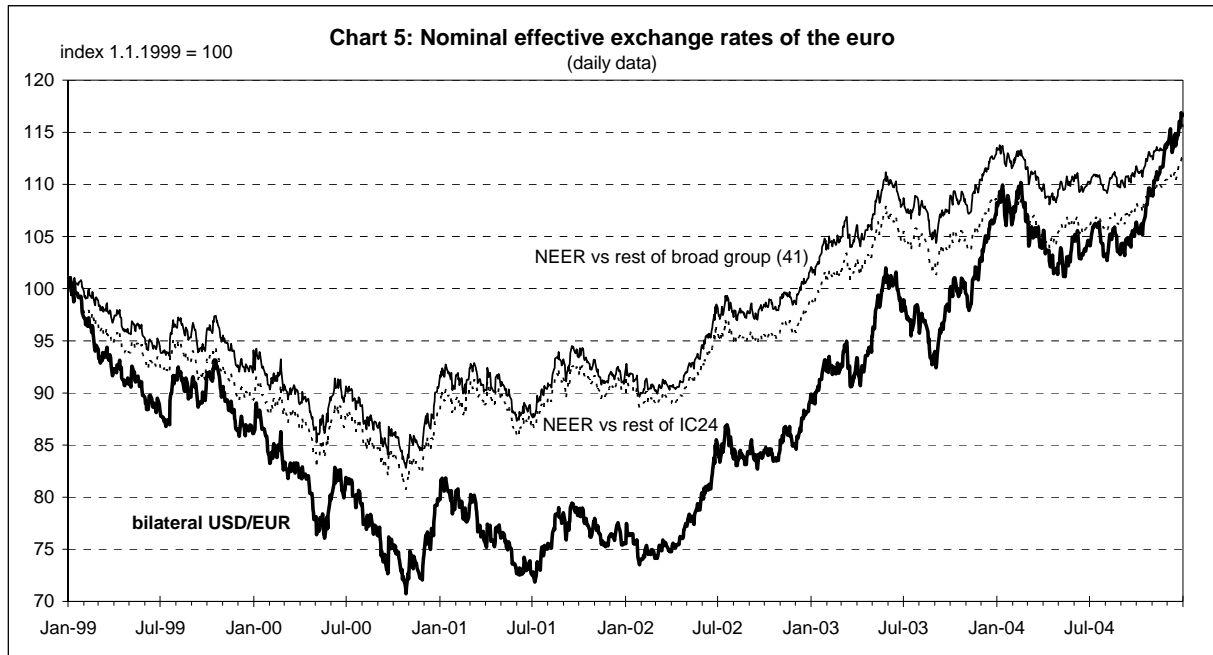
#### 1. BILATERAL EXCHANGE RATES OF THE EURO



**Table 1: Evolution of the main bilateral exchange rates**

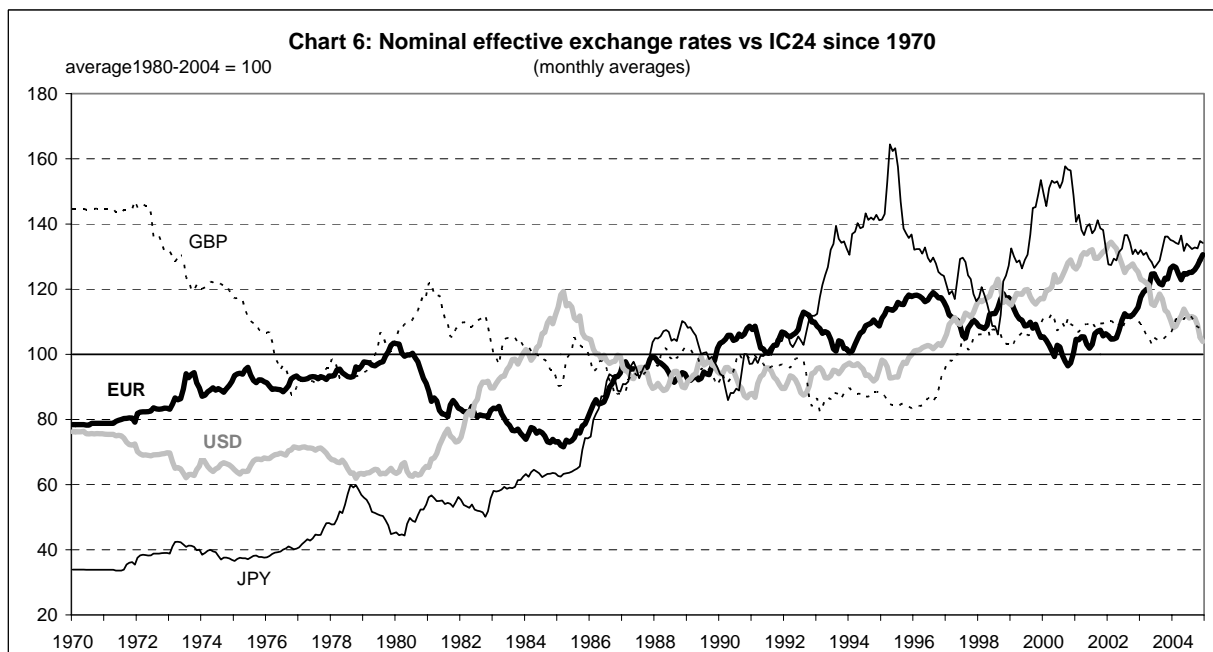
	During the fourth quarter of 2004 (monthly averages)			Change relative to previous periods (quarterly averages)		
	Oct-04	Nov-04	Dec-04	previous quarter Q4-04/Q3-04	previous year Q4-04/Q4-03	medium-term avg Q4-04/avg 95-04
USD/EUR	1.249	1.299	1.341	6.1%	9.0%	16.6%
JPY/EUR	136.0	136.1	139.1	2.0%	5.9%	8.4%
GBP/EUR	0.6914	0.6986	0.6950	3.4%	-0.3%	0.0%
CHF/EUR	1.543	1.522	1.536	-0.2%	-1.3%	-2.1%

## 2. NOMINAL EFFECTIVE EXCHANGE RATES

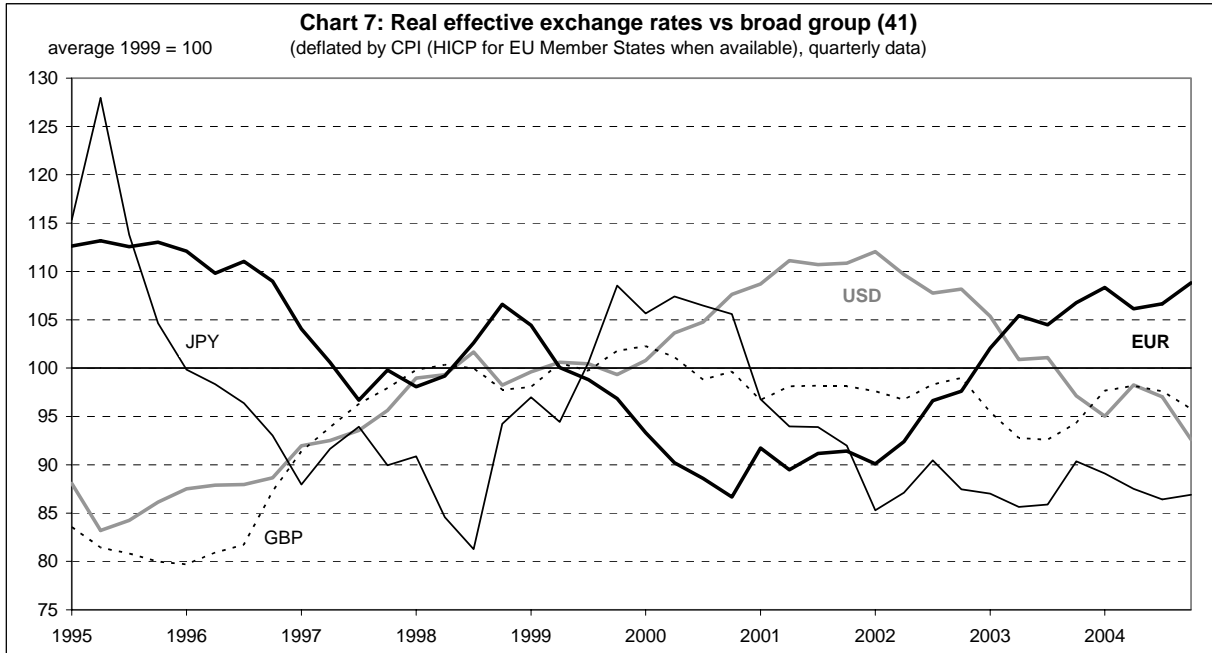


**Table 2: Nominal effective exchange rates**  
(vs. broad group (41), index average 1999 = 100)

	During the fourth quarter of 2004 (monthly averages)			Change relative to previous periods (quarterly averages)		
	Oct-04	Nov-04	Dec-04	previous quarter Q4-04/Q3-04	previous year Q4-04/Q4-03	medium-term avg Q4-04/avg 95-04
EUR12	116.5	118.0	119.3	2.5%	3.1%	19.1%
USA	95.8	92.8	91.7	-4.4%	-5.2%	-4.1%
Japan	100.8	102.7	102.4	1.2%	-0.9%	4.4%
UK	103.2	103.1	104.7	-1.9%	2.9%	8.1%

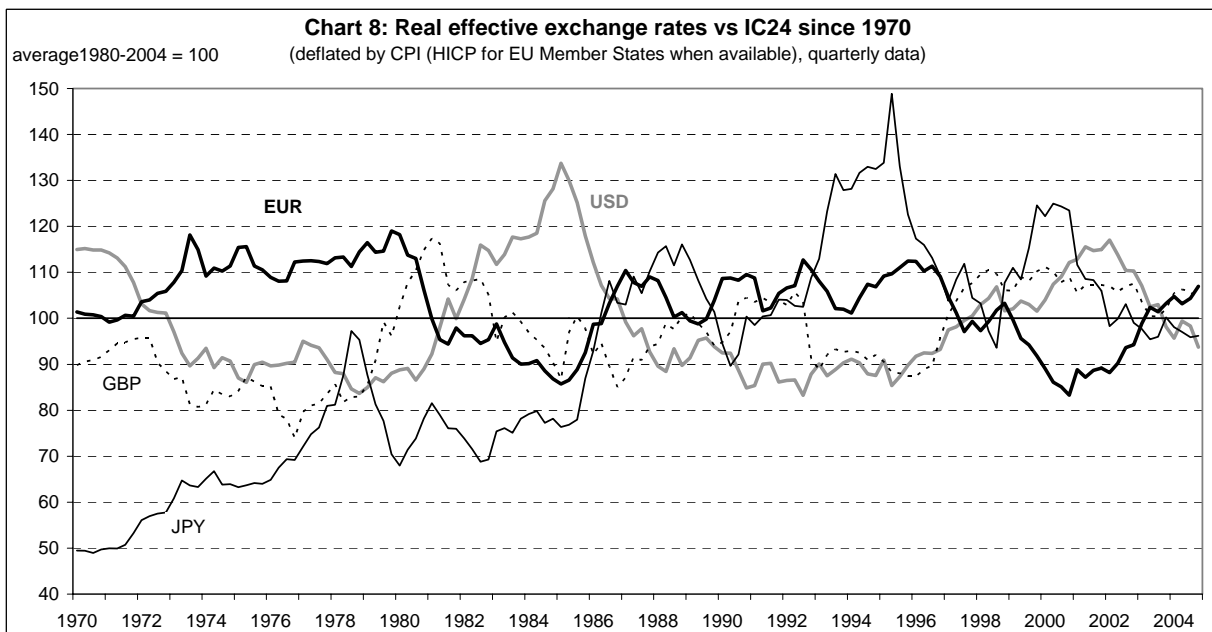


### 3. PRICE COMPETITIVENESS BASED ON CPI (HICP WHEN AVAILABLE)

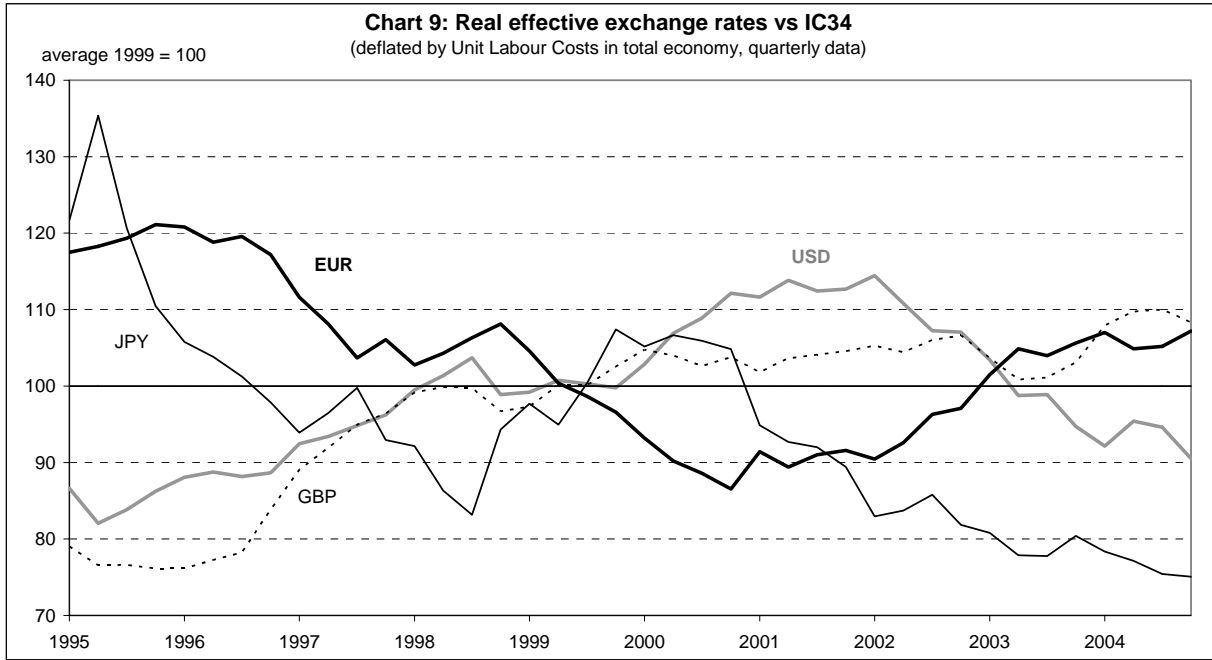


**Table 3: Real effective exchange rates (CPI / HICP)**  
(vs. broad group (41), index average 1999 = 100)

	Over the last year (quarterly averages)				Change relative to previous periods (quarterly averages)		
	Q1-04	Q2-04	Q3-04	Q4-04	previous quarter Q4-04/Q3-04	previous year Q4-04/Q4-03	medium-term avg Q4-04/avg 95-04
EUR12	108.3	106.1	106.6	108.8	2.0%	1.9%	7.5%
USA	95.0	98.2	97.0	92.6	-4.6%	-4.7%	-6.2%
Japan	89.1	87.5	86.4	86.9	0.6%	-3.8%	-8.9%
UK	97.7	98.2	97.6	95.8	-1.8%	1.5%	1.3%

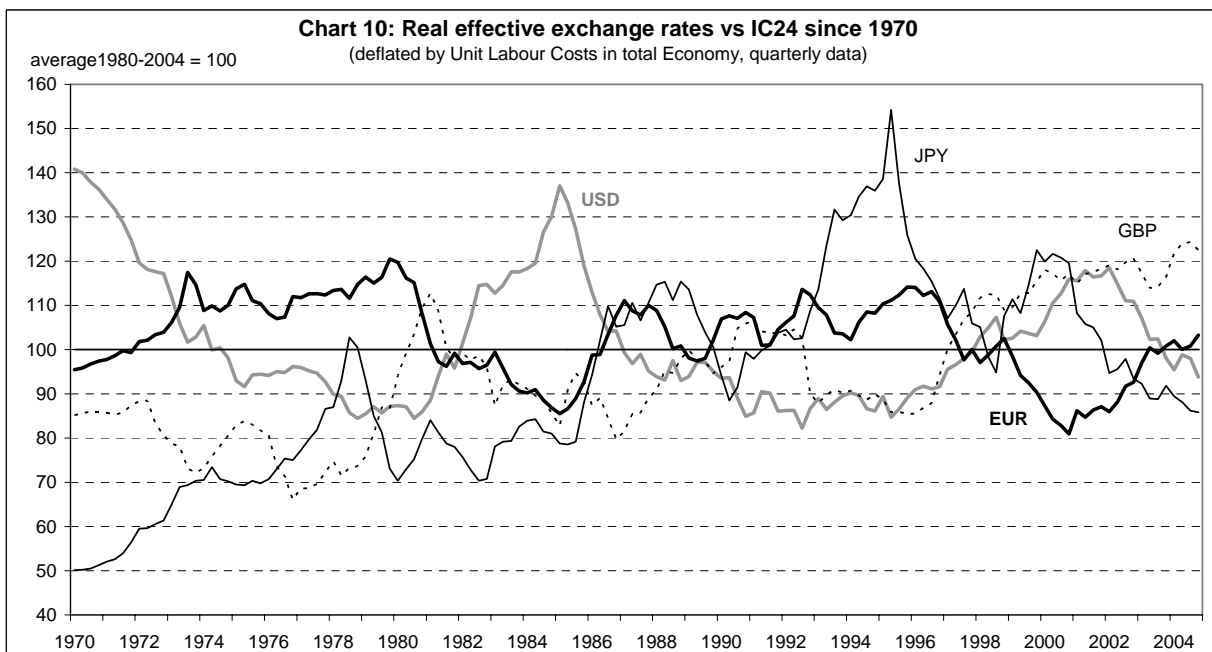


#### 4. COST COMPETITIVENESS BASED ON UNIT LABOUR COSTS IN TOTAL ECONOMY



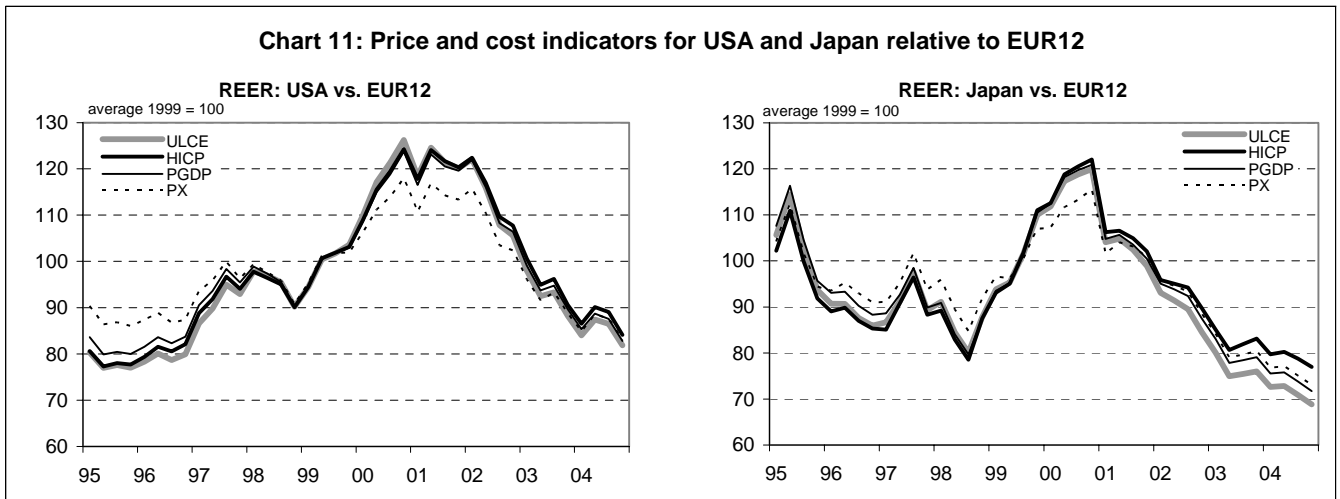
**Table 4: Real effective exchange rates (ULCE)**  
(vs. 34 countries, index average 1999 = 100)

	Over the last year (quarterly averages)				Change relative to previous periods (quarterly averages)		
	Q1-04	Q2-04	Q3-04	Q4-04	previous quarter Q4-04/Q3-04	previous year Q4-04/Q4-03	medium-term avg Q4-04/avg 95-04
EUR12	107.0	104.9	105.2	107.2	1.9%	1.5%	3.5%
USA	92.1	95.4	94.6	90.5	-4.3%	-4.4%	-8.6%
Japan	78.3	77.1	75.4	75.1	-0.5%	-6.7%	-20.7%
UK	107.9	109.8	110.0	108.3	-1.5%	5.1%	11.4%



## 5. COMPETITIVENESS OF THE USA AND JAPAN RELATIVE TO THE EURO AREA

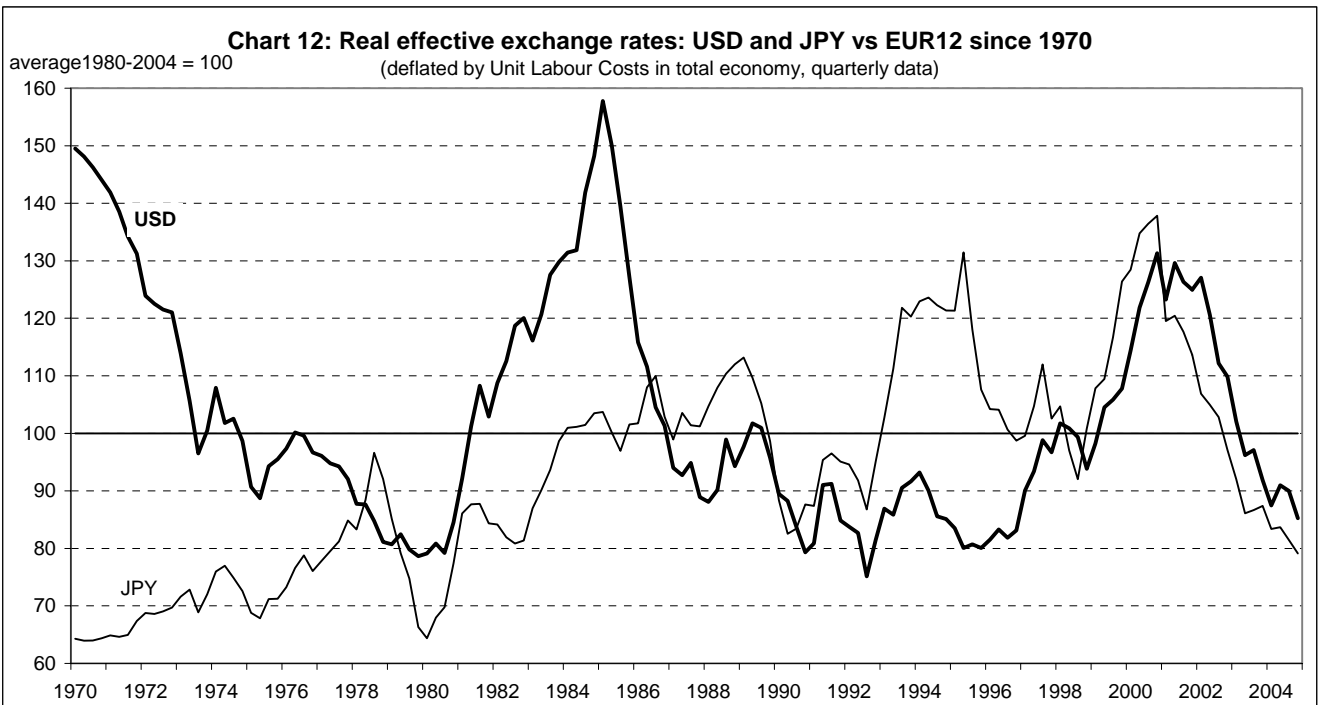
**Chart 11: Price and cost indicators for USA and Japan relative to EUR12**



**Table 5: Relative price and cost indicators of USA and Japan relative to EUR12**

% change	over last quarter Q4-04/Q3-04				over last year Q4-04/Q4-03				compared to MT average (95-04) Q4-04/avg. 95-04			
	ULCE	PGDP	PX	HICP	ULCE	PGDP	PX	HICP	ULCE	PGDP	PX	HICP
USA	-5.3%	-5.5%	-5.3%	-5.5%	-7.2%	-7.7%	-6.5%	-7.2%	-16.0%	-15.9%	-15.3%	-14.4%
Japan	-2.9%	-2.9%	-2.7%	-2.3%	-9.5%	-9.3%	-9.2%	-7.4%	-25.7%	-24.0%	-22.8%	-18.4%

**Chart 12: Real effective exchange rates: USD and JPY vs EUR12 since 1970**





## II. DEVELOPMENTS WITHIN THE EUROPEAN UNION

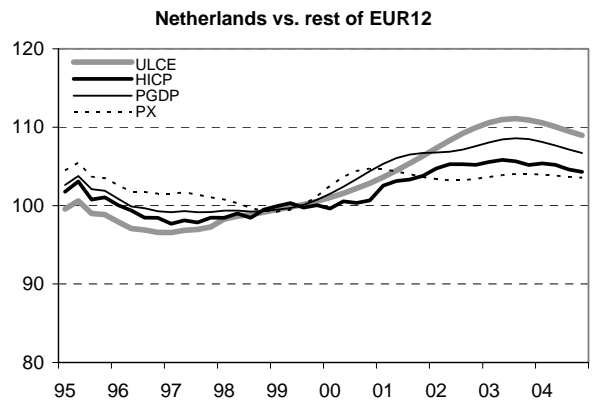
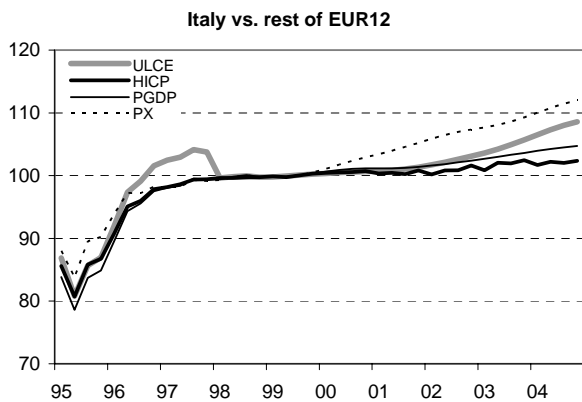
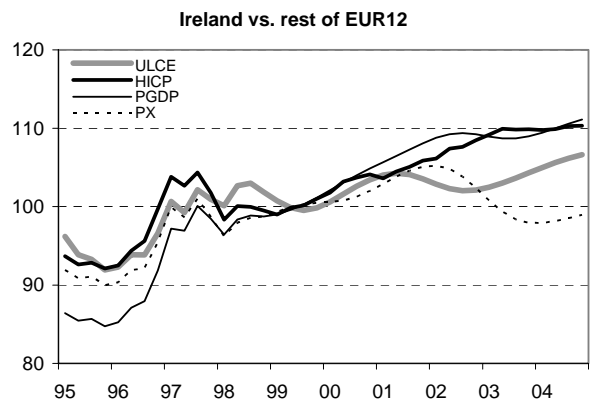
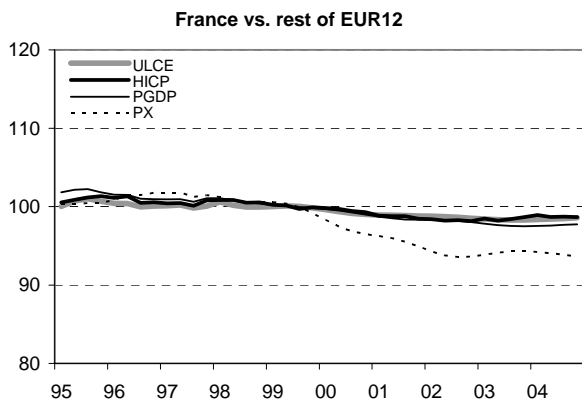
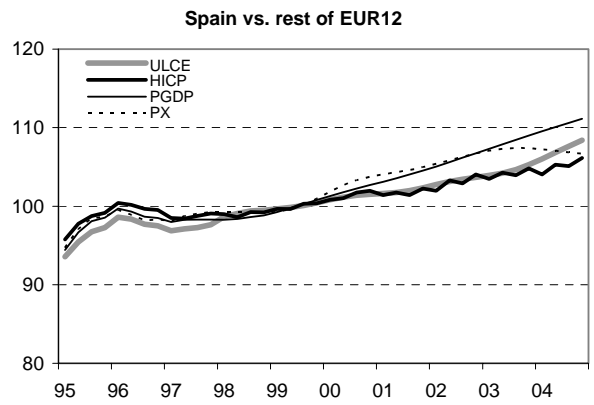
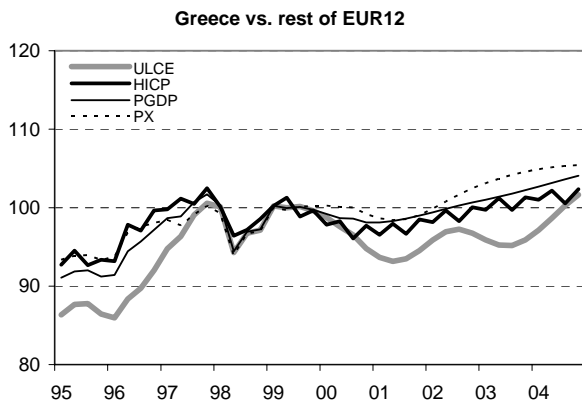
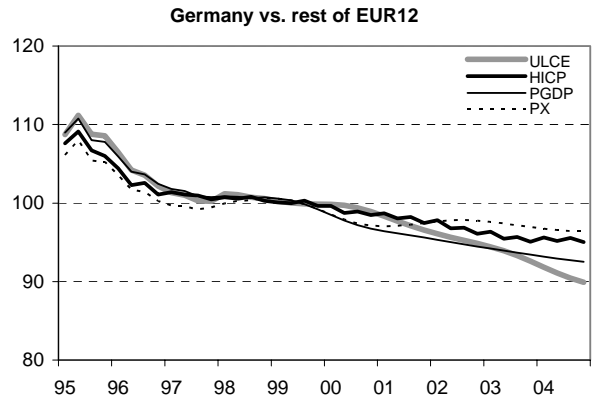
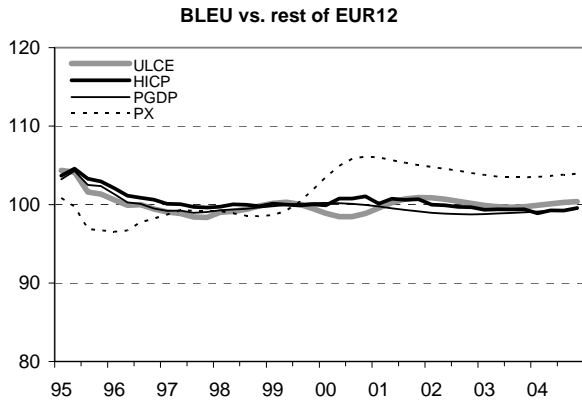
Within the euro area, diverging movements in costs and prices may change the relative cost competitiveness positions of euro area Member States. Table 6 and Chart 13 show four measures of the real effective exchange rate of individual Member States against EUR12 (abbreviations for the deflators are explained in the Annex). The different measures do not always give a uniform picture of the movement over time in the real effective exchange rate of a given country against its partners and, as such, the indicators of cost and price competitiveness need to be interpreted carefully.

In some cases, deviating price and cost trends among euro area Member States could lead to a build-up of competitive imbalances which might ultimately hamper economic growth and cause unemployment in individual Member States. In other cases, however, longer-term changes in relative prices and costs may be justified by changes in economic fundamentals related e.g. to a catching-up in the level of economic development, changes in non-price competitiveness factors, or changes in underlying savings and investment patterns. Moreover, differences in cyclical positions may cause movements in relative costs and prices in the short term. This report merely provides a descriptive overview of movements in intra-euro area cost and price competitiveness indicators.

<b>Table 6: Relative price and cost price indicators of the EU Member States vs. EUR12</b>													
	over last quarter Q4-04/Q3-04				over last year Q4-04/Q4-03				compared to MT average (95-04) Q4-04/avg. 95-04				
<b>Euro area Member States</b>													
% change	ULCE	PGDP	PX	HICP	ULCE	PGDP	PX	HICP	ULCE	PGDP	PX	HICP	
BLEU	0.1%	0.1%	0.1%	0.3%	0.7%	0.4%	0.4%	0.1%	0.4%	-0.4%	2.3%	-0.9%	
Germany	-0.6%	-0.2%	-0.1%	-0.6%	-2.9%	-1.0%	-0.6%	-0.1%	-9.3%	-6.6%	-3.1%	-4.6%	
Greece	1.4%	0.4%	0.1%	1.8%	6.0%	1.8%	0.8%	1.0%	6.6%	5.6%	6.0%	3.9%	
Spain	0.7%	0.5%	-0.2%	1.0%	3.0%	2.0%	-0.7%	1.3%	7.5%	8.7%	4.4%	5.0%	
France	0.1%	0.1%	-0.2%	-0.1%	0.3%	0.2%	-0.7%	0.0%	-0.9%	-1.9%	-4.3%	-1.0%	
Ireland	0.4%	0.5%	0.4%	0.0%	2.2%	2.0%	1.1%	0.4%	5.8%	10.2%	0.2%	7.5%	
Italy	0.5%	0.2%	0.5%	0.3%	2.7%	1.1%	2.5%	-0.1%	8.4%	6.1%	10.3%	4.0%	
Netherl	-0.5%	-0.4%	-0.1%	-0.3%	-1.8%	-1.6%	-0.4%	-0.8%	5.9%	3.3%	0.9%	2.6%	
Austria	0.2%	-0.2%	-0.1%	0.4%	1.2%	-0.7%	-0.6%	0.2%	-2.6%	-2.7%	-1.1%	-1.2%	
Portugal	0.2%	0.1%	-0.1%	-0.1%	1.0%	0.0%	-0.5%	0.1%	11.4%	5.3%	-1.0%	4.4%	
Finland	0.1%	-0.2%	-0.1%	-0.1%	0.4%	-1.1%	-0.2%	-1.9%	-0.4%	-3.2%	-12.0%	-2.6%	
<b>Non-euro area Member States</b>													
% change	ULCE	PGDP	PX	HICP	ULCE	PGDP	PX	HICP	ULCE	PGDP	PX	HICP	
CzechRep	2.2%	2.3%	1.4%	0.9%	5.6%	7.1%	3.7%	3.7%	26.4%	23.1%	9.4%	15.4%	
Denmark	0.3%	0.1%	0.1%	0.1%	1.4%	0.1%	0.5%	-0.9%	3.8%	1.4%	1.3%	0.1%	
Estonia	0.6%	0.8%	0.1%	0.4%	2.7%	3.0%	0.5%	2.6%	13.6%	16.6%	15.8%	11.4%	
Cyprus	0.4%	0.3%	-0.2%	1.8%	1.7%	1.3%	-0.5%	1.7%	6.8%	6.7%	2.4%	5.7%	
Latvia	-1.6%	-1.4%	-2.4%	-2.3%	2.6%	2.0%	-1.3%	1.0%	0.2%	6.7%	10.1%	2.2%	
Lithuani	0.7%	0.4%	0.4%	0.1%	2.8%	1.1%	1.4%	0.9%	14.4%	15.4%	15.2%	15.1%	
Hungary	1.9%	2.0%	0.9%	1.2%	9.7%	10.0%	4.9%	9.5%	33.1%	29.5%	4.1%	23.8%	
Malta	-1.1%	-1.1%	-0.3%	-3.7%	-0.7%	-0.1%	2.8%	-0.7%	4.0%	3.5%	2.4%	1.3%	
Poland	4.2%	5.0%	4.5%	4.9%	7.6%	11.3%	11.3%	11.7%	2.4%	3.6%	11.3%	7.1%	
Slovenia	0.4%	0.5%	0.2%	-0.4%	0.1%	0.6%	-0.1%	-0.3%	1.3%	3.4%	0.0%	2.8%	
Slovakia	2.1%	1.8%	1.0%	1.0%	8.5%	6.5%	2.0%	8.3%	25.9%	21.1%	8.0%	31.4%	
Sweden	1.5%	1.4%	1.5%	1.6%	-1.0%	-0.9%	-0.5%	-1.0%	-1.0%	-2.4%	-5.4%	-2.2%	
UK	-2.7%	-3.2%	-3.6%	-3.1%	2.9%	0.8%	-1.5%	-0.4%	5.4%	1.2%	-5.7%	-4.4%	

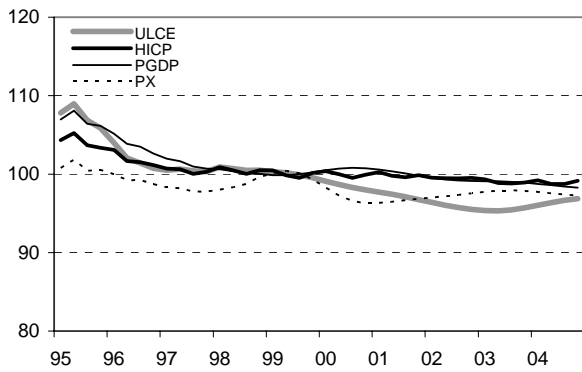
Note: relative ULCE for Italy relative to any period before 1998 are distorted by the 1998 tax reform which shifted taxation from labour costs to value added but did not significantly change competitiveness

**Chart 13: Price and cost indicators for EU Member States relative to EUR12**  
(average 1999 = 100)

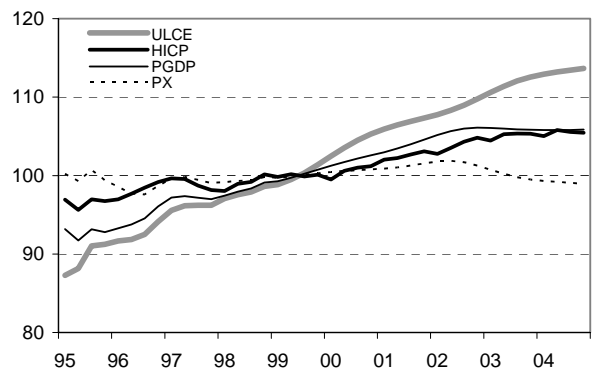


**Chart 13 cont'd: Price and cost indicators for EU Member States relative to EUR12**  
(average 1999 = 100)

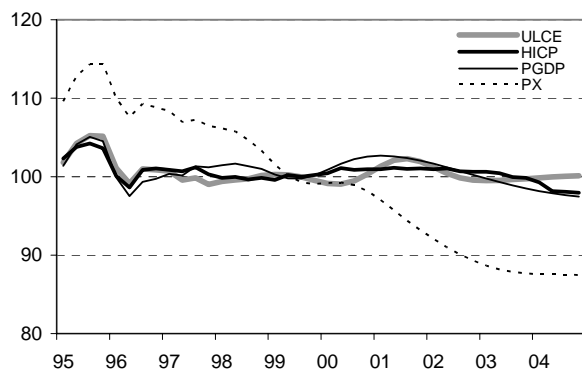
**Austria vs. rest of EUR12**



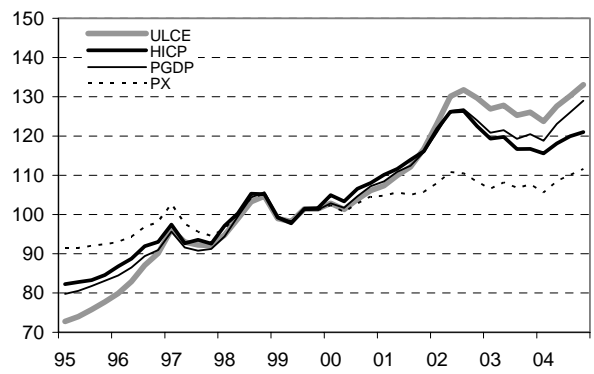
**Portugal vs. rest of EUR12**



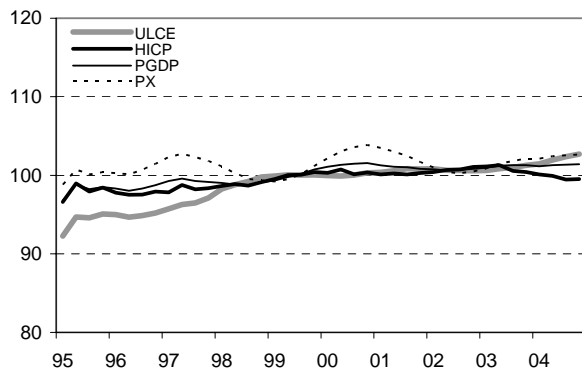
**Finland vs. rest of EUR12**



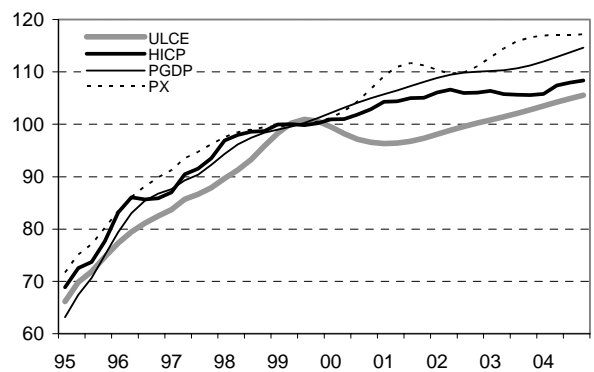
**Czech Republic vs. EUR12**



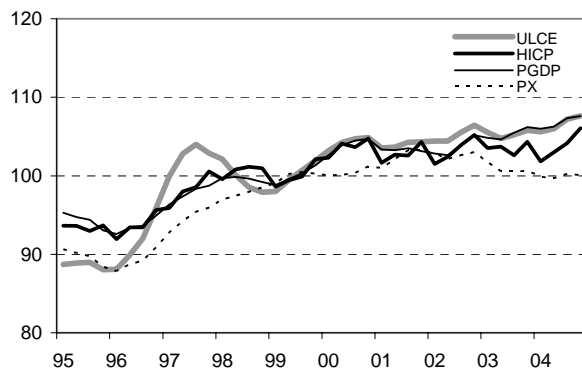
**Denmark vs. EUR12**



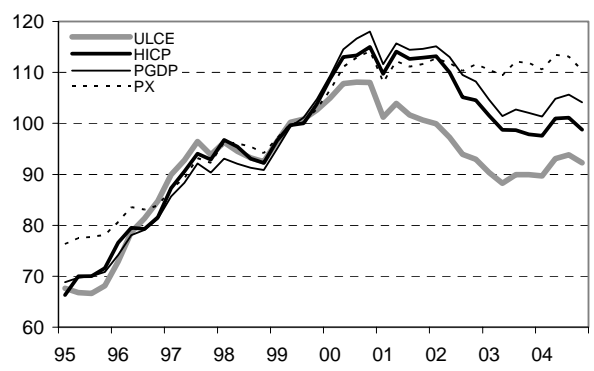
**Estonia vs. EUR12**



**Cyprus vs. EUR12**

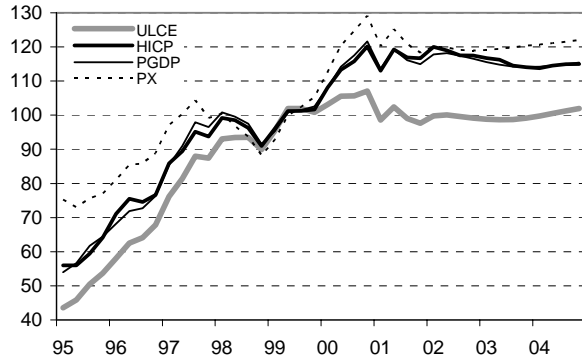


**Latvia vs. EUR12**

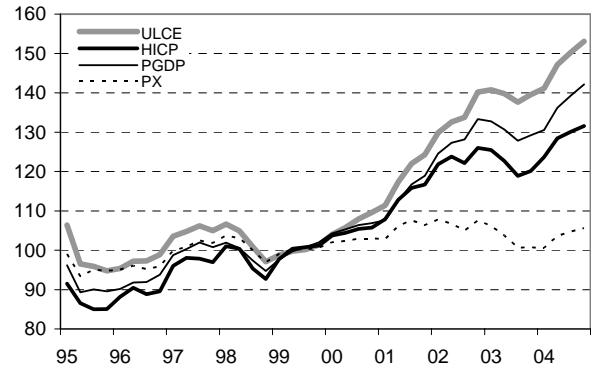


**Chart 13 cont'd: Price and cost indicators for EU Member States relative to EUR12**  
(average 1999 = 100)

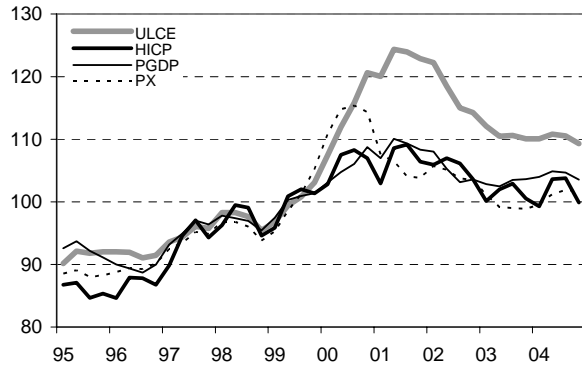
**Lithuania vs. EUR12**



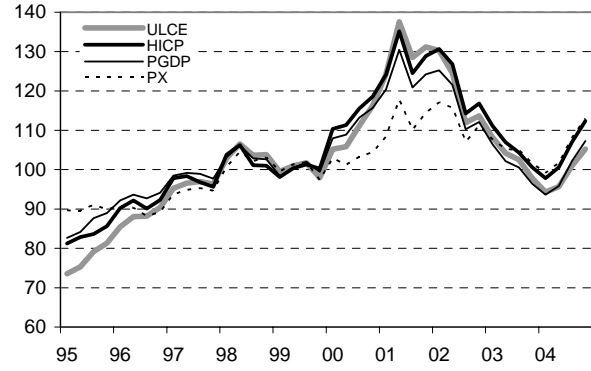
**Hungary vs. EUR12**



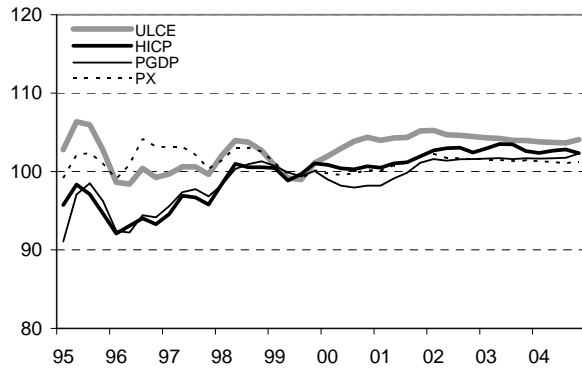
**Malta vs. EUR12**



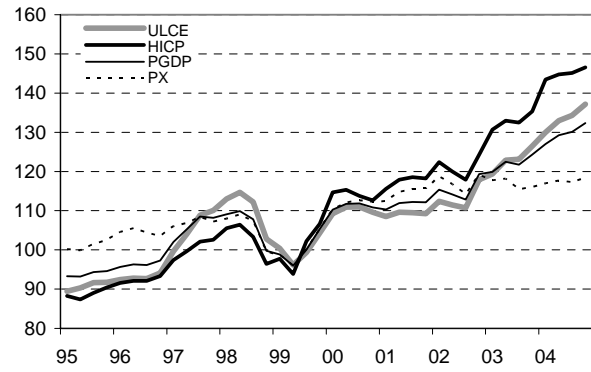
**Poland vs. EUR12**



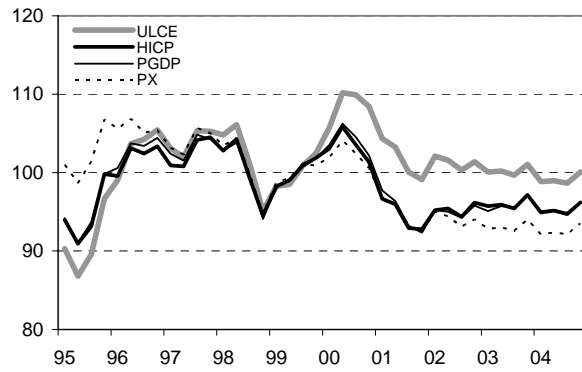
**Slovenia vs. EUR12**



**Slovak Republic vs. EUR12**



**Sweden vs. EUR12**



**UK vs. EUR12**

